

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING #08-19**

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Whether crates used for transporting packaged [FOOD] products are exempt for purposes of the Tennessee sales and use tax.

SCOPE

Revenue Rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue Rulings are advisory in nature and are not binding on the Department.

FACTS

The Taxpayer owns large quantities of returnable plastic containers, which are specially designed to hold [FOOD] products (the “crates”). The Taxpayer enters into written agreements to rent the crates to various [FOOD] producers, and sends the crates directly to [FOOD] producers located in Tennessee and other places throughout the United States. The [FOOD] producers place packaged [FOOD] products inside the crates, and send them directly to their distributors or to large grocery store chains.

The crates can be described as lidless trays with two metal bars across the top and handles on two sides; the crates are never used as direct food contact containers. A number of individual packages of [FOOD] products may be placed inside a single large plastic bag before being placed into a crate. The crates are not insulated, and are not shrink-wrapped.

The distributors ship the [FOOD] products to various stores in the crates. There is no separate charge by the [FOOD] producer to its distributor or to a grocery store for the crates. Rather, the cost is embedded in the price charged to the grocer, just as it would be with a corrugated cardboard container. Some stores remove the packaged [FOOD] products from the crates and place the packaged [FOOD] directly on the store shelves. Other stores place the crates directly on their shelves, where the packaged product is then removed by the stores’ customers.

The [FOOD] producers use the crates to ensure that the packaged [FOOD] products are not damaged or contaminated during shipment. Without the crates, the packaged [FOOD] products

could be damaged or contaminated if handled on an individual basis during shipment, resulting in a product that could not be sold. The alternative to using the crates would be to ship the [FOOD] products in non-returnable cardboard boxes. However, cardboard boxes are susceptible to damage during the shipping process, which would likewise result in damaged and unmarketable [FOOD] products. Once the crates are emptied, they are returned to the Taxpayer, who cleans and sterilizes them before the next use.

QUESTIONS

1. Prior to January 1, 2008, is the lease or rental of the crates by the Taxpayer exempt for purposes of the Tennessee sales and use tax?
2. Does the enactment of legislation conforming to the Streamlined Sales and Use Tax Agreement, effective January 1, 2008, change the exemption determination under Question #1?

RULINGS

1. No. Prior to January 1, 2008, the lease or rental of the crates by the Taxpayer is not exempt for purposes of the Tennessee sales and use tax.
2. No. The enactment of legislation conforming to the Streamlined Sales and Use Tax Agreement, effective January 1, 2008, does not change the exemption determination under Question #1.

ANALYSIS

1. *The Tennessee sales and use tax laws in effect prior to January 1, 2008.*

Prior to January 1, 2008, the lease or rental of the crates by the Taxpayer is not exempt for purposes of the Tennessee sales and use tax.

Retail sales in Tennessee are subject to sales and use tax under Tenn. Code Ann. § 67-6-101 (2006) *et seq.* Tenn. Code Ann. § 67-6-102(34)(A) (2006) defines a “retail sale” as “a taxable sale of tangible personal property . . . for any purpose other than for resale.”¹ However, Tenn. Code Ann. § 67-6-102(34)(E)(ii) (2006) specifically excludes from the definition of “retail sale” the sale, use, storage, or consumption of “[m]aterials, containers, labels, sacks, bags or bottles used for packaging tangible personal property when such property is either sold therein directly to the consumer or when such use is incidental to the sale of such property for resale.” Accordingly, the lease or rental of the crates by the Taxpayer will be subject to the Tennessee

¹ The lease or rental of tangible personal property comes within the scope of the definition of “retail sale” because Tenn. Code Ann. § 67-6-102(36)(A) (2006) defines a “sale” as “any transfer of title or possession, or both, exchange, barter, *lease or rental* . . . of tangible personal property for a consideration.” (Emphasis added.) Additionally, the rental or lease of tangible personal property in Tennessee is specifically subject to sales and use taxation pursuant to Tenn. Code Ann. § 67-6-204(a) (2006).

sales and use tax unless the crates come within the scope of the exemption for packaging materials provided under Tenn. Code Ann § 67-6-102(34)(E)(ii) (2006).²

TENN. COMP. R. & REGS. 1320-5-1-.11(1) (“Rule 11(1)”) interprets the exemption provided under Tenn. Code Ann § 67-6-102(34)(E)(ii) (2006). Note that Rule 11(1) must be read in conjunction with the statute; while the Commissioner of Revenue is authorized pursuant to Tenn. Code Ann. § 67-1-102 to prescribe reasonable rules and regulations not inconsistent with the taxing statutes, such rules and regulations may not enlarge the scope of either a taxing statute or an exemption. *Covington Pike Toyota, Inc. v. Cardwell*, 829 S.W.2d 132, 135 (Tenn. 1992); *Volunteer Val-Pak v. Celauro*, 767 S.W.2d 635, 637 (Tenn. 1989); *Coca-Cola Bottling Co. v. Woods*, 620 S.W.2d 473, 475-76 (Tenn. 1981). Rule 11(1) provides the following detailed explanation of those items that fit within the exemption for packaging materials: “Items actually accompanying the product sold or shipped, without which the delivery of the product is impracticable on account of the character of the contents, and for which there is no separate charge, are not subject to Sales or Use Tax. These items include such things as containers, packing materials, labels or name plate affixed to products manufactured, and printed matter containing only directions for use.”

In other words, under Tenn. Code Ann. § 67-6-102(34)(E)(ii) (2006), an item will be exempt from the Tennessee sales and use tax provided that the following requirements are satisfied: (1) the item is a material, container, label, sack, bag or bottle; (2) the item is used for packaging tangible personal property; and (3) the tangible personal property is either sold directly to the consumer in the packaging, or the use of the packaging is incidental to the sale of the tangible personal property for resale.

The Taxpayer’s crates satisfy the first requirement, because the crates are containers. However, the crates do not satisfy the second requirement of Tenn. Code Ann. § 67-6-102(34)(E)(ii) (2006), because the crates are not used for “packaging” tangible personal property. Neither the Tennessee Code nor the Tennessee courts have not defined the term “packaging” for purposes of Tennessee sales and use taxation. The Tennessee Supreme Court has stated that when a statute does not define a term, it is proper to look to common usage to determine the term’s meaning. *See, e.g., Tennessee Farmers Assur. v. Chumley*, 197 S.W.3d 767, 782-83 (Tenn. 2006); *Beare Co. v. Tennessee Dept. of Revenue*, 858 S.W.2d 906, 908 (Tenn. 1993). Webster’s Ninth New Collegiate Dictionary (1991) defines the term “packaging” as “to enclose in a package or covering.” The term “package” is in turn defined as “a covering, wrapping, or container.” These definitions suggest that, to be considered “packaging,” the item in question should be used to

² Based on the facts provided, the Taxpayer’s lease or rental of the crates does not come within the scope of any other sales and use tax exemption.

enclose, wrap, or otherwise fully contain tangible personal property.³

In the Taxpayer's case, the totality of the circumstances indicates that the crates do not enclose, wrap, or otherwise fully contain the [FOOD] products. Significantly, the crates are lidless trays with two metal bars across the top and handles on two sides; the crates do not provide full enclosure or containment of the [FOOD] products. While a number of individual packages of [FOOD] products may be placed inside a single large plastic bag before being placed into a crate, it is the plastic bag, and not the crate, that encloses or otherwise fully contains the [FOOD] products. Accordingly, the crates are not properly considered "packaging" for Tennessee sales and use tax purposes.

Even if the crates could be considered packaging, the crates would still fail to satisfy the third element of Tenn. Code Ann. § 67-6-102(34)(E)(ii) (2006), which requires either (1) that the tangible personal property be sold directly to the consumer in the packaging, or (2) that the use of the packaging be incidental to the sale of the tangible personal property for resale. In the Taxpayer's case, the [FOOD] products are not sold directly to the consumer in the crates (while the retail stores sometimes use the crates to display the [FOOD] products, the consumer never purchases a crate along with the [FOOD] products). Accordingly, the use of the crates must be "incidental" to the sale of the [FOOD] products for resale for the exemption to apply.

As noted above, Rule 11(1) interprets the exemption provided under Tenn. Code Ann § 67-6-102(34)(E)(ii) (2006). Rule 11(1) explains that delivery of the product must be "impracticable" without the item in question, on account of the character of the contents. For delivery to be impracticable, delivery of the product must generally necessitate the use of the item in question. For example, the Tennessee Supreme Court held that five-gallon, pressurized, cylindrical tanks that were used to deliver syrup, water, and carbon dioxide for resale to customers as soft drinks were exempt from the sales and use tax as containers used for packaging, because the tanks were incidental to the sale of the soft drinks. *Coca-Cola Bottling Co. v. Celauro*, 1993 WL 330303 at *2 (Tenn. August 30, 1993). Importantly, the court based its decision on the fact that the taxpayer had no alternative method of delivering the soft drinks to the customers in the absence of the tanks. *Id.* Conversely, a Tennessee chancery court held that open-topped milk crates used to transport cartons and plastic jugs of milk were not packaging material because the crates simply facilitated delivery of the milk. *Land-O-Sun Dairies, LLC v. Johnson*, No. 01-699-II (Chancery Court for the State of Tennessee, 20th Judicial District, Davidson County)

³ This approach is consistent with the outcomes of the few Tennessee court cases that discuss the sales and use tax exemption for packaging materials, even though none of the cases address the issue of whether the items in question constituted "packaging." For example, the Tennessee Supreme Court held that five-gallon, pressurized, cylindrical tanks that were used to deliver syrup, water, and carbon dioxide for resale to customers as soft drinks were exempt from the sales and use tax as containers used for packaging, under Tenn. Code Ann. § 67-6-102(34)(E)(ii) (2006) (then codified at Tenn. Code Ann. § 67-6-102(22)(E) (1993)). *Coca-Cola Bottling Co. v. Celauro*, 1993 WL 330303 (Tenn. August 30, 1993). Similarly, the Tennessee Supreme Court held that glass milk bottles were exempt as containers used for packaging, under an earlier, more broadly worded version of the exemption. *Evans v. Memphis Dairy Exchange*, 250 S.W.2d 547, 547 (Tenn. 1952). Notably, in each of these cases, the containers in question completely enclosed or otherwise fully contained the tangible personal property. In contrast, a Tennessee chancery court held that open-topped milk crates used to transport cartons and plastic jugs of milk did not qualify for the exemption. *Land-O-Sun Dairies, LLC v. Johnson*, No. 01-699-II (Chancery Court for the State of Tennessee, 20th Judicial District, Davidson County) (Memorandum and Final Order, October 3, 2002).

(Memorandum and Final Order at *9, October 3, 2002). The court found that the “sale of the milk necessitates that the liquid be stored in a container; the sale of the milk does not necessitate that the containers be transferred to the point of sale in any particular type of crate.” *Id.* at *8. The court also remarked that while the alternatives to the milk crates were economically prohibitive, “economic considerations are not the equivalent of the practical considerations to which Rule 11 alludes.” *Id.*

In the Taxpayer’s case, delivery of the [FOOD] products is not impracticable without the crates. Generally speaking, the sale of [FOOD] products necessitates some form of packaging to prevent contamination; however, the individual packages in which the [FOOD] products are wrapped serve this purpose. While the crates are likely the most convenient and economical way to deliver the [FOOD] products, the sale of the [FOOD] products does not *necessitate* the use of the crates. Rather, the crates simply facilitate delivery of the [FOOD] products to the stores in which they are sold. As with the sale of milk, the Taxpayer could choose an alternate method of delivery. Accordingly, the crates are not incidental to the sale of [FOOD] products for resale, and fail to satisfy the third element of Tenn. Code Ann. § 67-6-102(34)(E)(ii) (2006).

The burden is on the taxpayer to establish entitlement to an exemption from taxation. The Tennessee Supreme Court has stated that “[a]lthough the rule is well-established that taxing legislation should be liberally construed in favor of the taxpayer and strictly construed against the taxing authority, it is an equally important principle of Tennessee tax law that ‘exemptions from taxation are construed against the taxpayer who must shoulder the heavy and exacting burden of proving the exemption.’” *American Airlines, Inc. v. Johnson*, 56 S.W.3d 502, 506 (Tenn.Ct.App. 2000) (quoting *Rogers Group, Inc. v. Huddleston*, 900 S.W.2d 34, 36 (Tenn.Ct.App. 1995)). The Tennessee Supreme Court has also stated that the burden is on the taxpayer to establish the exemption, and any well-founded doubt is sufficient to defeat a claimed exemption from taxation. *American Airlines, Inc. v. Johnson*, 56 S.W.3d at 506 (citing *Tibbals Flooring Co. v. Huddleston*, 891 S.W.2d 196, 198 (Tenn. 1994); *United Cannery, Inc. v. King*, 696 S.W.2d 525, 527 (Tenn. 1985)). For the reasons stated above, there is sufficient doubt as to the Taxpayer’s entitlement to claim an exemption under Tenn. Code Ann. § 67-6-102(34)(E)(ii) with respect to the crates.

Because the requirements under Tenn. Code Ann. § 67-6-102(34)(E)(ii) (2006) are not satisfied in their entirety, the lease or rental of the crates by the Taxpayer is subject to Tennessee sales and use taxation.⁴

2. *The Tennessee sales and use tax laws in effect beginning January 1, 2008.*

The enactment of legislation conforming to the Streamlined Sales and Use Tax Agreement, effective January 1, 2008, does not change the determination that the Taxpayer’s crates are not exempt for Tennessee sales and use tax purposes as packaging materials.

⁴ Note that the rental of the crates by the Taxpayer will also generally be subject to the Tennessee business tax. See Tenn. Code Ann. §§ 67-4-701 *et seq.* for details.

In 2007, Tennessee enacted a number of provisions related to the Streamlined Sales and Use Tax Agreement, effective January 1, 2008. However, the exemption for packaging materials is not affected by this legislation. Accordingly, for purposes of the Tennessee sales and use tax, the lease or rental of the crates by the Taxpayer continues to be subject to sales and use taxation after the legislation's effective date. Note that the exemption for containers and packaging materials is codified effective January 1, 2008, under Tenn. Code Ann. § 67-6-329(a)(13) (2007). The language of Tenn. Code Ann. § 67-6-329(a)(13) (2007) is identical to that found under Tenn. Code Ann. § 67-6-102(34)(E)(ii) (2006). Furthermore, Rule 11(1) remains in force, and therefore applies to the exemption of packaging materials under the Tennessee sales and use tax laws in effect beginning January 1, 2008.

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